

Write your name on the cover of the test booklet and nowhere else. Enclose this sheet with the booklet. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 225 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I can give SOME extra time but not much.

1) (10 points) For EITHER the requirement in Part A OR the one in Part B, explain why the Maastricht Treaty made that a pre-requisite to using the euro.

A) A government's debt must not exceed 60% of that country's GDP.

B) A country's inflation rate must not exceed by more than 1.5 percentage points, the average of the three community members with the lowest inflation rates.

2) (10 points) Answer EITHER Part A OR Part B.

A) Explain the advantage of a crawling peg over a fixed exchange rate.

B) Explain the advantage of a managed float over a clean float.

3) (10 points) Answer EITHER Part A OR Part B.

A) Which is flatter, the AD curve for a closed economy or the AD curve for an open economy with a fixed exchange rate? Explain your logic.

B) Explain why the AD curve slopes down.

4) (12 points) Answer EITHER Part A OR Part B.

A) On the IB/EB diagram, which curve is flatter? Explain the economic reason why that curve is flatter.

B) On the IB/EB diagram, put a point in one of the small triangles between the EB and IB lines. Does the point show unemployment or inflation? Does that point show surplus or deficit? Explain your logic.

5) (14 points) If the ruler of your home country asked your advice, what type of exchange rate regime would you recommend for them? Explain your logic. Give at least two reasons why you make that choice.

6) (18 points) Answer EITHER Part A OR Part B.

A) What is dollarization? What are one disadvantage and one advantage of it?

B) What is meant by a band around a peg? What are one disadvantage and one advantage of it?

7) (20 points) Illustrate EITHER the event in Part A OR the event in Part B on the LRAS/SRAS/AD diagram. Explain why the curve(s) moved as drawn. What happens to the price level and the GDP?

A) Interest rates decrease.

B) The supply of labor increases.

8) (20 points) Answer EITHER Part A OR Part B.

A) In 1990, prior to the movement towards one currency, Italy's government had a deficit of 10%

of GDP and a government debt of 100% of GDP. These were too high to be allowed into the euro zone. What did the Italian government have to do to eliminate that problem? What would the economic effects of those policies be? Explain how the policies would have those effects. Do you think it was wise for Italy to enter the euro zone? Explain your logic.

B) Until 1987, prior to the movement towards one currency, France had high inflation rates. The rate was too high to be allowed into the euro zone. What did the French government have to do to eliminate that problem? What would the economic effects of those policies be? Explain how the policies would have those effects. Do you think it was wise for France to enter the euro zone? Explain your logic.

9) (36 points) Illustrate EITHER the event in Part A OR the event in Part B on the IS/LM LRAS/SRAS/AD diagrams. Explain why the curve(s) moved as drawn. What happens to the price level, interest rates and the GDP? Illustrate the SAME event on both diagrams.

A) Money supply increases.

B) Income tax is increased.